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# THE *Myth* ABOUT *Credit Reports*

BY RICHARD DOWNING JR.

WHAT IS A COMMODITY, ANYWAY? SALT? NATURAL GAS? PORK BELLIES? AUTOMATED CREDIT REPORTS? The classic definition of a commodity is a product that contains the same qualities and specifications, regardless of its source, and for which the price is controlled not by quality but by supply and demand. ■ Does this sound like an appropriate description for an information product on which a decision involving hundreds of thousands of dollars should be made? Not likely, especially when part of the decision process involves elements such as interest rates, down payments and other variables. In truth, the quality of loan underwriting is directly tied to the quality of credit information and service provided. ■ The importance of quality credit reporting is a "no-brainer" to the mortgage industry, yet this vital element of the underwriting process is, more often than not, thought of as a commodity. Why is this?

**All credit reports are not the same. The 10 percent of loan applications that differ from the norm often require the tailor-made expertise of credit information specialists. Credit reports, contrary to the myth, are anything but commodities.**

The answer is simple. Credit reports *are* a commodity product for about 90 percent of loan applications where the loan is completely conforming, the credit information is straightforward and accurate, and decisions are standard. Using these criteria, it could be said that underwriters are also a commodity because, on a majority of loans, decisions are simple and mostly routine.

However, just as no one wants to ride in a plane being flown entirely on automatic pilot, no mortgage lending operation can operate efficiently and profitably on automated underwriting alone. It is the nonstandard 10 percent or so of loan applications that makes the difference. It is the way these loans are handled that can ultimately differentiate one credit-reporting company from another.

*Comprehensive and accurate credit reporting delivered promptly can mean saving a loan rather than losing it to a competitor.*

"The purchase of detailed borrower information from the [credit] repositories is already considered a commodity item," says Craig Focardi, senior analyst with TowerGroup, Needham, Massachusetts. "Today, credit reporting technology—used to collect, store and retrieve credit report information—gives those firms an operating cost advantage. On the sales side, vendors package and sell credit reports with other products and services to differentiate themselves and to 'de-commoditize' credit reports as a stand-alone product."

The United States has three national credit repositories—Chicago-based TransUnion; Orange, California–based Experian; and Atlanta-based Equifax—that collect, store and disseminate consumer credit data. Although the borrower's raw credit data from any of the three national repositories is essentially a commodity item, once lenders start combining and reviewing the information in the context of a mortgage transaction, it can no longer be viewed as a commodity, and the need for assistance and customer service from credit reporting companies increases exponentially. Mortgage credit-reporting companies understand this and have procedures, programs and customer service agents in place to assist borrowers. Moreover, they have the ability to verify and solve conflicts quickly—something the repositories are very slow to do. The likelihood of speaking with a customer service representative at a mortgage credit-reporting company is much higher than it would be if contacting a credit repository directly.

### Critical mortgage credit-reporting components

Three things happen with a mortgage loan application, with respect to credit. The first thing mortgage credit-reporting companies must do is efficiently process the 85 percent to 90 percent of loan applications that contain no disputed credit items and require no further investigation. Second, they must quickly identify the 10 percent to 15 percent of borrowers with nonstandard credit information and form a reasonable remedy for each. And finally, they must provide relief to frustrated borrowers and thoroughly resolve each disputed credit report without creating a large bottleneck in the underwriting process.

Resolving credit conflicts and/or inconsistencies is where quality credit reporting becomes critical. Credit information can affect the underwriting decision in multiple ways. The most obvious one is a "go-or-no-go" decision on qualifying for the loan. But this information can also determine rates and terms.

Less obvious, but still very important, is the client relations issue. Comprehensive and accurate credit reporting delivered promptly can mean saving a loan rather than losing it to a competitor. Consumer patience is much shorter in today's fast-paced environment, and applicants are quick to look for alternatives. Unlike supermarkets or hair stylists, customers seek mortgage loans so infrequently that virtually no brand loyalty is involved.

"The ability to quickly resolve disputed credit data can make the difference between keeping the loan or losing it," says Jerry Devlin, regional vice president in Miamisburg, Ohio–based National City Mortgage Company's Boston office. "Our mortgage credit-reporting company helps us improve our level of service to the customer and help us retain more business."

Losing a "sale" has a negative impact in many ways. First, there is no profit. In fact, such aborted transactions can be viewed as an expense because every organization invests in marketing and every prospect has a specific dollar acquisition cost. When this is added to the administrative costs of a lost loan application (or one that might have been made with better credit information), the cost can be significant.

Another, more subtle, loss may also be incurred. A sizable portion of mortgage loan business is generated by word-of-mouth. If borrowers have a positive origination experience, then they may tell two or three people about the specific lender they used. However, a dissatisfied borrower might tell seven or eight people, and bad news travels fast. A lost loan also means one fewer satisfied customer generating good public relations about you. And who knows how many potential customers are lost due to negative public relations about their experience.

There is another long-term negative impact from not delivering consistent customer service in loan underwriting. High-performing loan originators are the most valuable asset of any lending institution. They are the lifeblood of a successful mortgage lending operation. They should be able to perform with the confidence that their business will be handled expeditiously and the belief that every reasonable effort will be made to win approval for the loan application. These top originators need strong processing and underwriting support to help them succeed. If lenders are not choosing efficient, high-quality credit information vendors, they risk the disenchantment of their high-performing originators.

### What constitutes a quality credit report?

Information is information, and credit information contained on most reports comes from the same source or multiple sources—so what difference does it make which

provider you use? The "three-file" merging of information obtained from the three major national credit repositories could be viewed as restaurant choices. Most restaurants use the same basic ingredients, but it makes a world of difference how the raw materials are processed.

Credit reporting is much the same. The mortgage lending industry today relies heavily on merged reports from all three repositories. The perfect credit report is a hybrid of skillfully blended credit information from multiple sources. It is this blending that takes credit reporting completely out of the realm of commodity. The ability to analyze and evaluate disparate credit information from several sources, resolve discrepancies and flag conflicting information is critical to the final product that allows an underwriter to make an appropriate decision.

Every loan that goes through automated underwriting (AU) at one of the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, has a credit report ordered for it. The GSEs pull as much credit data on a borrower as they can obtain. They order reports from each of the three repositories. However, the methods they use to gather this information is unique to each entity.

Fannie Mae's Desktop Underwriter® (DU) orders merged credit reports from mortgage credit-reporting companies. Fannie Mae has direct connections with these companies, and when a loan is submitted through its DU system it can access and order the credit report. If, however, the lender has already pulled a three-file merged report, Fannie Mae has the ability to get a copy of the file directly from the originating credit-reporting company. The AU system combines the credit information with the other attributes of the loan and renders a decision.

Freddie Mac operates somewhat differently. Regardless of whether the customer already has a three-file merged report, Freddie Mac's Loan Prospector® orders a credit report for each application from all three repositories independently. It brings that data into its AU system and makes a determination on the loan.

In cases where credit information may not be up to the standard necessary to render a positive decision instantly, the AU systems send messages back to the lender stating that additional credit inquiries are required. This is where the lender comes to rely on credit-reporting companies to quickly help resolve conflicting or erroneous data.

### Compounding errors

Errors in borrower credit information from the repositories may be minimal when looking at each repository's error percentages. However, once the information from all three repositories is combined to create the standard merged credit file acceptable for the mortgage industry, the errors can be compounded by a factor of three. In other words, if the borrower's credit information from all three repositories is only 90 percent accurate, then once combined, the merged report could be as much as 30 percent inaccurate. And that could spell the difference between getting loan approval or not.

On the other hand, borrower-initiated credit disputes have always been a huge problem for both lender and borrower. This is especially true in cases where there is no clear-cut approval and the borrower has his or her own story about what happened regarding the disputed item(s). Such circumstances still have to be verified, authenticated and resolved quickly.

The process of purchasing a new home is one of the most stressful transactions the average consumer ever encounters. The last thing a borrower needs is erroneous credit information looming over his or her head while going through this process. The last thing a lender needs is a strained relationship with the borrower over incorrect credit data.

"For that 10 [percent] to 15 percent of reports that come through and need the 'human touch,' the credit reporting vendor's service level and turnaround time is integral to our success," says Lynn Weaver, executive vice president of Operations at Waterfield Mortgage Co. Inc., Fort Wayne, Indiana. "Our deadline to have that information is the same whether the report goes through the automated decision program or not."

While it would be efficient and cost-effective to reduce all credit evaluation to an instantaneous, automated process, the nonconforming segment of the business makes this impractical. It is these loan applications that especially need responsive, quality service.

"The way that a credit reporting vendor handles disputed information on a report is integral to my success," says Bill Slosberg, president of Washington, D.C.–based Millennium Mortgage Bankers Inc. "If you can't help the borrower resolve the discrepancies, you could lose not only their business, but it could potentially damage your relationship with the Realtor as well."

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One size doesn't fit all in shoes or in credit reports. Multiple levels of reports are available to accommodate the loan application where the loan is not immediately approved for credit reasons. Applications that need further credit investigation conducted after a merged credit report can take advantage of "mini-investigation" credit reports, or in extreme cases fully developed residential mortgage credit reports (RMCRs). Previously ordered credit reports are saved and used to begin work immediately in resolving any credit-related issues.

### Who is responsible for commoditizing credit reports?

As the long-gone comic strip character "Pogo" once said, "We have identified the enemy . . . and it is us." If 85 percent of applications are sailing through the system without the need for human intervention, it is only natural for

lenders to want 100 percent of them to require such little attention. But credit reporting simply doesn't operate this way. There will always be exceptions and there will always be borrowers who need conflicts resolved. Service providers will be judged on how well they can handle this 15 percent of applications. The level of service these companies provide for this percentage can be critical in developing and maintaining a good relationship with the lender.

***Credit-reporting costs, on a per-loan basis, have decreased—largely due to the increased use and popularity of merged-repository credit reports.***

Technology advancements and delivery improvements—such as dedicated high-speed lines connecting lenders and service providers, Internet delivery, server-based applications that require no client-side software and portals—have significantly reduced the cost of delivering credit reports. Ironically, these technologies are not cheap or easy to implement.

This cost savings has also contributed to the industry's mistaken view of credit reports as a commodity whose price can be continually squeezed. While the industry reaps the benefits of reduced credit reporting costs, it should not lose sight of the fact that the quality of those reports cannot be compromised without other kinds of serious costs being incurred.

### Bundled services

There seems to be confusion among most mortgage industry professionals about the definition of what is known as bundled services. In a nutshell, bundled services enable the lender to go to one provider to receive all the peripheral fulfillment services (appraisal, flood, title, credit reports, document preparations, etc.) needed to originate a loan. However, there is more than one approach to this one-stop shopping.

The vendors that first formed the overall concept of bundled services had a terrific idea. But the model they offered often included one or two components where the solution in the package may not be best in class. Most bundled-services providers began as specialized vendors offering only one service. When they made the decision to move outside their core competency, the service and/or technology offered depended on which companies they were able to acquire to fill out their menu of bundled services.

In the opinion of some, the package of services is not always the best available in the industry, but there is the obvious tradeoff of getting more convenience and lower prices. The tradeoff is worthwhile for a growing number of lenders in the very competitive mortgage market. But some lenders have reservations.

"Whenever you use a bundled-services provider, you are getting the lowest common denominator," says Slosberg. "Each of the vendors that provide a piece of the puzzle are not going to go the extra mile for their customers. There's just no incentive for them to. Lenders use bundled services for convenience and to save money. Some of them don't seem to mind that the quality of information and service is compromised."

"For some mortgage lenders, it may make sense to use a bundled-service provider because it allows you to get some economies of scale all delivered via a single interface," says Cathryn Perry, senior vice president of vendor management for Columbia, Maryland–based Columbia National Inc. "But I think that if you serve a lot of niche markets, like we do, it may not be as efficient as it sounds. We have fully integrated the electronic and product advantages from many best-in-class vendors with our seamless loan process and delivery systems. This integration gives us huge advantages over using a single bundled-service provider."

This is why it is important for lenders considering an agreement with a bundled-services provider to "look inside the bundle" and be certain that each service is up to their standards for service and data quality.

"There are a lot of people pushing bundled services in the industry," says Waterfield Mortgage's Weaver. "We have not gone down that path because we have very good working relationships with our vendors, and we value those relationships more than the chance to save a dollar or two here or there. It may take a little more effort to manage the disparate vendor accounts [as far as billing, etc.], but it's worth it to us because we are confident in the quality of data and level of service we receive."

This is not to suggest that technology-driven, one-stop shopping should not be used. Lenders should leverage technology that gives them the ability to access multiple services from one portal. The mortgage industry should encourage advancements in delivery technology. Traditional methods for delivering credit reports, such as dial-up and single-use communication lines, are far too expensive and create redundant costs. The industry will be under pressure from the borrowing public until the process becomes much easier and faster.

In my view, a better bundled-services solution is the portal model, in which lenders can individually choose their own fulfillment providers and create their own custom bundles of settlement-service providers electronically.

### What about the bottom line?

Credit-reporting costs, on a per-loan basis, have decreased—largely due to the increased use and popularity of merged-repository credit reports. Merged reports are accepted by the secondary market agencies, are quicker to produce and are less expensive than a traditional, full-blown, residential mortgage credit report. This is due to automated processes used by mortgage credit-reporting companies that combine raw in-file data from the repositories quickly and efficiently.

Ironically, the rise in popularity of the merged-repository report has made RMCRs more expensive to produce. This has resulted from a growing trend of lenders ordering RMCRs only when there appears to be a problem. Such problems might include obvious errors in the merged report, credit items disputed by the borrower or conflicting information

among the repositories that requires further investigation.

The average time to investigate an RMCR has more than doubled. Many companies have yet to pass along this cost to lenders, but indicate that cost increases are under consideration. In addition, increased raw data costs due to legislation such as The Gramm-Leach-Bliley Act (November 1999) and the Fair Credit Reporting Act (originally passed in April 1971, with significant changes made in 1992 and 1996) are passed along to mortgage credit-reporting companies and, ultimately, mortgage lenders in the form of higher costs for mortgage credit reports.

Consumers are sensitive to costs, too. "Lenders compete with each other based on product and price. The efficiency of their operations lets them adjust their price. If they can lower the cost of a credit report to a borrower, this can help them better compete with other lenders," says TowerGroup's Focardi.

In fact, over the past five years, credit-reporting costs have been reduced by as much as 35 percent. No other fulfillment area of mortgage lending has seen such a dramatic improvement in costs. However, even with this significant cost reduction, some lenders try to cut costs further by compromising the services extended to the 10 percent of borrower applications with nonstandard credit information. In my view, that is a flawed strategy.

### What you should look for in a credit-report provider

If credit reports are not a commodity, then credit-report providers are not commodity vendors either. There are many factors that should be taken into consideration before partnering with a vendor.

Lenders need to take a look at the firm's infrastructure to know if that vendor will be able to handle the volume of loans the lender might be sending its way. If the vendor doesn't have the technological capabilities to handle a lender's requests, the relationship is doomed to fail. The vendor must have a national program of service and support to meet the needs of a lender's customers. Advancements in technology and application service providers (ASPs) are allowing even small brokers doing business in a limited area to access a national, best-in-class list of service providers.

Customer lists, references, number of partners and length of time in business all speak to the stability of the provider. The ideal vendor should have a proven track record with many successful years in business and have a list of satisfied clients willing to speak on the vendor's behalf.

"For lenders looking for a credit-reporting provider, I would suggest that they look beyond the requisite functions of three merged files, dupe checks, etc., that have become standard," says Weaver. "They should look for a vendor with customer service that is available well beyond the usual 8-to-5 business day. We take applications 24/7, and if we have a customer who needs assistance, they must be able to speak with someone. We have loan officers sitting with borrowers taking applications from their laptops, and if we can't pull the credit report, it turns into a difficult and embarrassing situation for us."

Weaver also emphasizes the need for a qualified, competent and responsive staff. "Also, the capacity to handle volume must be scalable," he says, "in order to accommodate peaks as well as normal volume."

The working relationship with a provider is also important, according to Weaver. "Vendors need to keep us abreast of what other lenders are doing in the industry," he says. "Let us know what's going on from your vantage point, opportunities that may be on the forefront, keep us in the loop more as a business partner [and] less as a client/vendor relationship. It benefits us both to work this way."

For some lenders, the only thing that differentiates one vendor from another is price. Loan origination is an expensive process. But lenders should know where to cut costs and where not to. The accuracy of credit data is essential when making a loan. If that information is incorrect, then it affects all the other variables of the loan.

"There are far too many areas in mortgage banking that are affected by service providers' technology," says Columbia National's Perry. "We have interfaces from the point-of-sale all the way through loan closing and servicing, and they are all very integrated and key to providing customers with value. So before you select a credit reporting vendor, you have to involve members of all departments that will be affected."

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"It is so important for credit history information to be correct," says Chip Coffay, director of lending at Fannie Mae. "We would expect lenders to perform the appropriate level of due diligence before selecting a vendor. Lenders should know what they are getting for the price they are paying. The lowest bidder doesn't always have the best-quality data or customer service. We would not recommend selecting a vendor solely based on price."

### The last word

As recently as five years ago, the average price for a credit report was about $40. Today, it's closer to $20. At the same time, delivery mechanisms have improved dramatically. However, for prices to move lower, service must suffer. This may seem attractive in the short term, but may have serious and damaging consequences over time.

While it may be difficult for credit-reporting companies to justify the cost to lenders for maintaining service organizations that only handle 10 percent to 15 percent of the credit-report requests, the value of such an effort is plain to see. Likewise, informed and forward-thinking lenders understand its value. A wise man once said, "If costs were everything, then we would all be driving Yugos." There aren't many Yugos left on the road today. **MB**

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